IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	
JENNY HIATT,	)	**Case No. 97-02906**
	)	
Debtor.	)	**MEMORANDUM OF DECISION**
	)	
	)	
_____	)	
	)	
FARMERS INSURANCE GROUP,	)	
	)	
Plaintiff,	)	
	)	
vs	)	**Adversary No. 99-6318**
	)	
JOHN H. KROMMENHOEK, as trustee of the bankruptcy estate of Jenny Hiatt and JENNY HIATT,	)	
	)	
Defendants.	)	
	)	
_____	)	

HONORABLE TERRY L. MYERS, UNITED STATES BANKRUPTCY JUDGE

D. Blair Clark, RINGERT CLARK, Boise, Idaho, for Plaintiff.

Jed. W. Manwaring, EVANS KEANE, Boise, Idaho, for Defendant Trustee.[1]

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[1] It appears Defendant Jenny Hiatt was served, but she has never appeared in (continued...)

INTRODUCTION

Farmers Insurance Group ("Plaintiff") seeks entry of summary judgment. Defendant Trustee, John H. Krommenhoek ("Trustee") resists the motion and, although he has not filed a cross motion for summary judgment, contends relief should be entered in his favor. *See*, Memorandum in Opposition to Motion for Summary Judgment, at 2. There are no factual disputes presented, only conflicting views of the proper legal effect to be given undisputed facts.

BACKGROUND

The Debtor Jenny Hiatt ("Debtor") was injured in an automobile accident in October, 1996. She filed her chapter 7 bankruptcy petition in 1997. Debtor was covered by insurance issued by Plaintiff. An action was pursued against the other party involved in the accident (called herein, without pejoration, "tortfeasor") and his insurance carrier, State Farm. Attorney Larry Sirhall was retained by Trustee to pursue the recovery on behalf of the estate.

The record establishes that Sirhall also represented Plaintiff in order to recover subrogation benefits from the tortfeasor and State Farm. This subrogation claim related to $15,000.00 Plaintiff paid on pre-petition debts to Debtor's medical providers pursuant to the terms of Debtor's insurance policy with Plaintiff. Part III, Coverage E of that policy provides:

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[1](...continued)
this adversary proceeding, nor has default been sought against her.

PART III – MEDICAL

Coverage E-Medical Expense Coverage

> We will pay **reasonable expenses** for **necessary medical services** incurred within three years from the date of the **accident** because of **bodily injury** sustained by an **insured person** . . . [.][2]

In October 1999 the Court approved a compromise pursuant to which a gross amount of $40,000.00 was recovered from the tortfeasor and his carrier. Sirhall's total fees and costs incurred in relation to this recovery are in the amount of $14,718.12.[3]

Plaintiff brought the present action to determine the right, title and interest of the parties to the personal injury proceeds. The contentions of Plaintiff are based upon Part V (5) of the policy which provides:

> **PART V – CONDITIONS**
> . . .
>
> **5. Our Right To Recover Payment**
> In the event of any payment under this policy, we are entitled to all the rights of recovery of the person to whom payment was made against another. That person must sign and deliver to us any legal papers relating to that recovery, do whatever else is necessary to help us exercise those rights and do nothing after loss to prejudice our rights.

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[2] The emphasis appears in the policy, indicating defined terms.

[3] In the event Plaintiff is successful in recovering the $15,000.00 it claims under the subrogation rights in the policy, Plaintiff agrees it would be liable for 15/40th's of the $14,718.12 and agrees that its recovery can be surcharged to that extent.

> When a person has been paid **damages** by us under this policy and also recovers from another, the amount recovered from the other shall be held by that person in trust for us and reimbursed to us to the extent of our payment.
>
> This condition does not apply if prohibited by **state** law.

Trustee disputes that this contract provision, or bankruptcy law generally, allows Plaintiff to recover the $15,000.00 in reimbursement of the medical expense coverage Plaintiff provided its insured, the Debtor.

DISCUSSION

Summary judgment may be granted if, when the evidence is viewed in a light most favorable to the non-moving party, there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c); Fed.R.Bankr.P. 7056; *Margolis v. Ryan* 140 F.3d 850, 852 (9th Cir. 1998). As noted above, the parties agree that no genuine issues of material fact exist, and that they dispute only the legal effect to be given to the agreed facts established by the record.

Plaintiff makes several arguments. It contends that, as a blanket rule, property of the estate under § 541(a)(1) does not include sums which are payable or paid if those sums are subject to subrogation rights. Plaintiff also argues that the subrogation proceeds are not property of the estate due to operation of § 541(b)(1).[4]

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[4] Section 541(b)(1) provides:

> (b) Property of the estate does not include–
> (1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor[.]

Plaintiff further contends that, if the funds become property of the estate, the insurance contract between Debtor as insured and Plaintiff as insurer requires Debtor's Trustee to hold the subrogated funds in trust for the benefit of Plaintiff.

A. Property of the estate

The personal injury cause of action was property of the bankruptcy estate. § 541(a)(1); *Wischan v. Adler (Matter of re Wischan)*, 77 F.3d 875, 877 (5th Cir. 1996); *In re Western Drywall, Inc.*, 145 B.R. 661, 671, 92 I.B.C.R. 186, 192 (Bankr. D. Idaho 1992). The fruits of that action would be as well, at least as an initial matter.

But while § 541(a)(1) is intentionally broad in scope, it does not expand a debtor's rights in property over what existed as of the date of filing. *In re Waters Asbestos Co.,* 96.3 I.B.C.R. 103, 104 (Bankr. D. Idaho 1996); *Elsaesser v. Trefz (In re Taylor),* 95 I.B.C.R. 213, 214-15 (Bankr D. Idaho 1995). The question is whether and to what extent, under the contract and applicable nonbankruptcy law, Debtor had an interest in the funds allegedly subject to the subrogation claim. *Taylor*, 95 I.B.C.R. at 215.[5]

[5] Plaintiff argues that *In re Hinkle*, 86 I.B.C.R. 134 (Bankr. D. Idaho 1986) establishes that a recovery, to the extent of any subrogation claim, does not constitute property of the estate. However, the court's focus in *Hinkle* was on the doctrine of recoupment and an alleged violation of stay, not characterization of funds subject to the subrogation rights as being within or without the estate.

1. Rights under the contract

Plaintiff contends that it has paramount claim to $15,000.00 of the recovery by virtue of the terms of Part V(5) of the insurance policy it issued to the Debtor, quoted above. However, this provision actually addresses two separate and distinct situations.

a. Subrogation to rights of payees

First, it provides that "in the event of any payment [made by Plaintiff] under this policy, [Plaintiff is] entitled to all the rights of recovery **of the person to whom payment was made against another**." Part V(5) (emphasis supplied here by the Court). The only persons that Plaintiff paid under the policy were the medical service providers. Thus, by virtue of these payments Plaintiff is "entitled to" (or, alternatively phrased, subrogated to) all the rights of recovery of these medical providers, *i.e.* "the person(s) to whom payment was made," which those providers may have against Debtor or others.

The rights of the medical service providers against Debtor or her estate would appear to be nothing more here than general unsecured claims. Medical service providers do have the ability to claim liens for services they render. *See* Idaho Code § 45-704(B). But no contention is here raised that any of these providers asserted liens or that Plaintiff is attempting to assert through subrogation any such lien rights.

The policy, at Part V(5), would also appear to require the medical providers to take such actions as necessary to help Plaintiff enforce its rights and do nothing to prejudice Plaintiff. But that would be an issue solely between the providers and

Plaintiff.[6] It simply appears that the medical service providers have unsecured claims against Debtor and her estate and Plaintiff is, by this portion of Part V(5) of the policy, subrogated to these unsecured claims.

b. Rights to the insured's recovery

The policy also provides at Part V(5) that:

> When a person has been paid **damages** by us under this policy and also recovers from another, the amount recovered from the other shall be held by that person in trust for us and reimbursed to us to the extent of our payment.

Unlike the subrogation rights of Plaintiff to the claims of the medical service providers, this clause appears to create a contractual right of Plaintiff against the Debtor to the extent that she is "a person [who] has been paid damages by [Plaintiff] under this policy and also recovers from another." There is no contest that Debtor has recovered from another, to wit the tortfeasor. Has she previously "been paid damages" by Plaintiff?

The policy's definitions provide "[**d**]**amages** are the cost of compensating those who suffer **bodily injury** or **property damage** from an **accident**." Policy, at 3. Plaintiff paid Debtor's bills incurred with medical service providers by reason of her bodily injury arising from the accident. Plaintiff asserts that Debtor has been "compensated" in regard to her injuries and has received or "been paid damages" by Plaintiff within the contemplation of Part V(5) of the policy. Plaintiff therefore contends

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[6] Nothing has been presented which indicates that Plaintiff asked for and failed to receive assignments of rights, or that the medical providers refused on Plaintiff's demand to assert their lien rights.

that the monies recovered by Trustee for Debtor's estate are subject to the contract proviso that they be held in trust for Plaintiff's benefit and used to reimburse Plaintiff to the extent Plaintiff has paid out those damages. However, Trustee argues that Plaintiff, in paying providers under the medical coverage provisions of the policy, did not pay damages to Debtor.

Even though ambiguities in insurance contracts are to be construed most strongly against the insurer, there must first be an ambiguity requiring such construction. *Mutual of Enumclaw Ins. Co. v. Roberts*, 128 Idaho 232, 235, 912 P.2d 119, 122 (1996). In order to create that ambiguity, Trustee reads the policy as providing that the only amounts which would be subject to the definition of "damages" would be those amounts paid directly to Debtor and not those paid to third parties on her behalf. Thus, in order to preserve its rights, Plaintiff would be forced to issue funds to the Debtor for use in payment of medical service providers, or even mechanics and body shops for repair of physical damage to her vehicle. If the insurer paid those claims directly to the third party medical providers or repairmen, it would void or eliminate its ability to recover under the reimbursement and subrogation provisions.

The plain language of the policy at Part V(5) clearly purports to grant the insurer a right of subrogation to the position of the payees and a right of recovery against the insured. If such a significant, bright-line limitation on this professed

right existed, it would be reasonable to assume it would be clearly set forth in the policy. Trustee's proposed construction of these provisions is rejected.[7]

2. Extent of the Debtor's, and estate's, interest

As noted above, § 541(a)(1) does not expand the interests of a debtor in property over what existed under applicable nonbankruptcy law. Plaintiff contends that the contractual limitations on Debtor's interests apply with equal vigor in bankruptcy. Plaintiff here emphasizes the language of the policy which states that, to the extent the Debtor has received damages and then recovers from a third party, the recovery "shall be held . . . in trust" for Plaintiff and reimbursed to the Plaintiff to the extent of its earlier payment.

Plaintiff argues that the contractual limitation falls under § 541(b)(1). However, the Court concludes this assertion is in error. That provision deals not with the extent of or limits on a debtor's rights in property but, rather, with "powers" a debtor may exercise solely for the benefit of another. *See generally*, 5

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[7] As stated in *Mutual of Enumclaw*, 128 Idaho at 236, 912 P.2d at 123:

> There is no obligation on courts to countenance a tortured construction of an insurance contract's language in order to create an ambiguity and thus provide an avenue for coverage where none exists.

Collier on Bankruptcy, ¶ 541.19, p. 541-93 to 541-96 (15th rev.ed. 1999).[8]

Still, the Code does support Plaintiff's underlying contention. Section 541(d) provides in pertinent part:

> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

In *Arizona Health Care Cost Containment System v. Nelson (In the Matter of Yakel),* 97 B.R. 580 (D. Arizona 1989), the Court considered the subrogation claims of a state agency which had paid the debtors' medical bills. The agency contended, as Plaintiff does here, that the amount of the settlement recovered by the debtors

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[8] Trustee also contends that § 552(a) operates to free the recoveries from any claim of Plaintiff under its policy. Section 552(a) establishes that property acquired by the estate after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the Debtor prior to bankruptcy. In order for Trustee to prevail, the Court must find that the insurance policy actually was or contained a "security agreement" and that Plaintiff's claims to the funds are consensual lien claims. Section 101(50) defines a security agreement as an "agreement that creates or provides for a security interest." Notwithstanding the fact that no "magic words" are required to create a security agreement, *Simplot v. William C. Owens, M.D., P.A.,* 119 Idaho 243, 245-46, 805 P.2d 449, 451-52 (1990), the Court does not find that the insurance policy manifests an intention to grant the insurer a security interest in funds recovered by an insured. Section 552(a) is simply inapplicable.

which was necessary to reimburse the agency could not be considered property of the estate. The Court stated:

> Congress specifically exempted from the bankruptcy estate property the debtor does not hold an equitable interest in. Congress explained its intent with regard to this exemption as follows:
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> > Section 541 will not apply in those instances where property which ostensibly belongs to the debtor is in reality, held by the debtor in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance and the insurance company had sent payment of those bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, the payment would actually be held in constructive trust for the person to whom the bill was owed. The payment would not, therefore, become property of the estate pursuant to Section 541.
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> H.R.Rep. No. 595, 95th Cong., 1st Sess., 367-8 (1977); S.Rep. No. 989, 95th Cong., 2d Sess., 82-3 (1978) reprinted in 1978 U.S. Code Cong. & Admin. News 5787.
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> Because equitable title to that portion of the settlement representing medical costs AHCCCS expended never became part of the estate of Donald and Carol Yakel, the bankruptcy court erred in ordering appellee Miller & Pitt to turnover those funds to appellee George Nelson [trustee]. Appellee George Nelson holds AHCCCS's portion in a constructive trust for the benefit of AHCCCS.

97 B.R. at 581-82. *Accord, In re Squyres*, 172 B.R. 592 (Bankr. C.D. Ill. 1994).[9]

As noted earlier, § 541(a)(1) does not expand the rights of a debtor in property. Section 541(d) recognizes this fact in those situations where applicable nonbankruptcy law limits the debtor's interests to bare legal title with the equitable interests held by another. In *Yakel*, the subrogation right was provided by statute. Here it stems from contract. The distinction is immaterial. The question is, rather, whether nonbankruptcy law limits the debtor's rights to the funds in the face of the subrogation claim.

This approach to the issue is consistent with that used in *Swayne v. Allied Fidelity Insurance Co. (In re Crum)*, 83 I.B.C.R. 71 (Bankr. D. Idaho 1983). There the dispute focused on a "retained percentage" withheld by the State of Washington on a bonded public construction project on which debtors had worked. The trustee demanded the retained fund from the state. The surety on the bond had paid

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[9] The term "constructive trust" appears in the legislative history, *Yakel* and *Squyres* but caution is warranted since the Ninth Circuit generally takes a dim view of constructive trust claims in bankruptcy. *See, Airwork Corporation v. Markair Express, Inc. (In re Markair, Inc.)*, 172 B.R. 638, 641-42 (9th Cir. BAP 1994) and cases cited therein. *See also*, *In re Pintlar Corporation*, 1995 WL 42442 at *2 (Bankr. D. Idaho 1995) (if this remedy is inchoate at the time of bankruptcy, it is subordinate to the trustee's rights and powers, citing *In re Tleel*, 876 F.2d 769, 771-72 (9th Cir. 1989)); *Custer v. Dobbs (In re Dobbs)*, 115 B.R. 258, 269-71, 90 I.B.C.R. 179, 193-97 (Bankr. D. Idaho 1990). The Court would note, however, that the rights of the subrogated creditor in *Yakel* do not appear to be premised on a "constructive trust" as that term is properly defined. *See Markair*, 172 B.R. at 642. In *Yakel*, and particularly here, the analysis depends not upon the imposition of the equitable remedy of constructive trust but instead upon the determination of the extent of the debtor's interests (including lack of equitable interests) at the time of filing.

subcontractors due to the debtors' defaults, and claimed the retained fund through subrogation. The Court held:

> I conclude that [the fund] was not [property of the estate] even though all legal and equitable interests of a debtor as of the filing of the petition for relief became property of the estate. Any interest of the debtor or the estate was contingent, unearned, and subject to the superior equitable rights of the subcontractors and defendant surety. As the Supreme Court noted, only if a contractor completes the obligations of the contract and pays his subcontractors would he have become entitled to the fund.

83 I.B.C.R. at 73, relying upon *Pearlman v. Reliance Insurance Company*, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed.2d 190 (1962). The equitable interests of Debtor here are similarly, though not identically, circumscribed.[10]

The proceeds of the settlement of the personal injury claim which were engineered by Sirhall became property of the estate. However, the Court concludes that the interests of Plaintiff under its contractual right to subrogation is sufficient to elevate its claim to $15,000 of the recoveries over the right and interest of Debtor under state law and thus over the rights of Trustee. Under § 541(d), Debtor has legal title to that portion of the recovery, while Plaintiff holds the equitable interest.

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[10] Plaintiff argues that *Crum* directly controls the characterization of the funds subject to the subrogation claim in this case. The Court disagrees. *Crum* dealt with the unique issue of a surety bond and the limitations on the interest of a debtor in contractually retained percentages. The Court in *Crum* did not announce a general ruling that subrogation claims were always superior to claims of the debtor or estate, or that funds subject to subrogation claims were always excluded from the estate. Subrogation rights may arise in several ways, and it is appropriate to evaluate the facts and circumstances of each case where such rights are asserted in order to determine if and to what degree such funds enter the estate.

CONCLUSION

Based upon the foregoing, Plaintiff is entitled to summary judgment as requested. Counsel for Plaintiff shall prepare a form of judgment which provides that the $15,000.00, less such sum as represents 15/40th's of Sirhall's allowed costs and fees incurred in generating the recovery, shall be paid over to Plaintiff by Trustee.

Dated this 30th day of June, 2000.